

MINIMISING THE RISKS IN SHIP FINANCING

Maximising competitiveness by securing cost-effective financing

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Reducing the risk of Default

1. The Term Sheet and Finance Documentation: the provisions of these documents will trigger default scenarios.

Please see specimen Term sheet (Appendix A)

Key Terms:

- **The Borrower-** use a single purpose shipowning Company.
- **Currency swap option-** in times of currency fluctuations it's important to include this option. Also consider 'hedging'.



The Swiss Franc Mortgage Trap

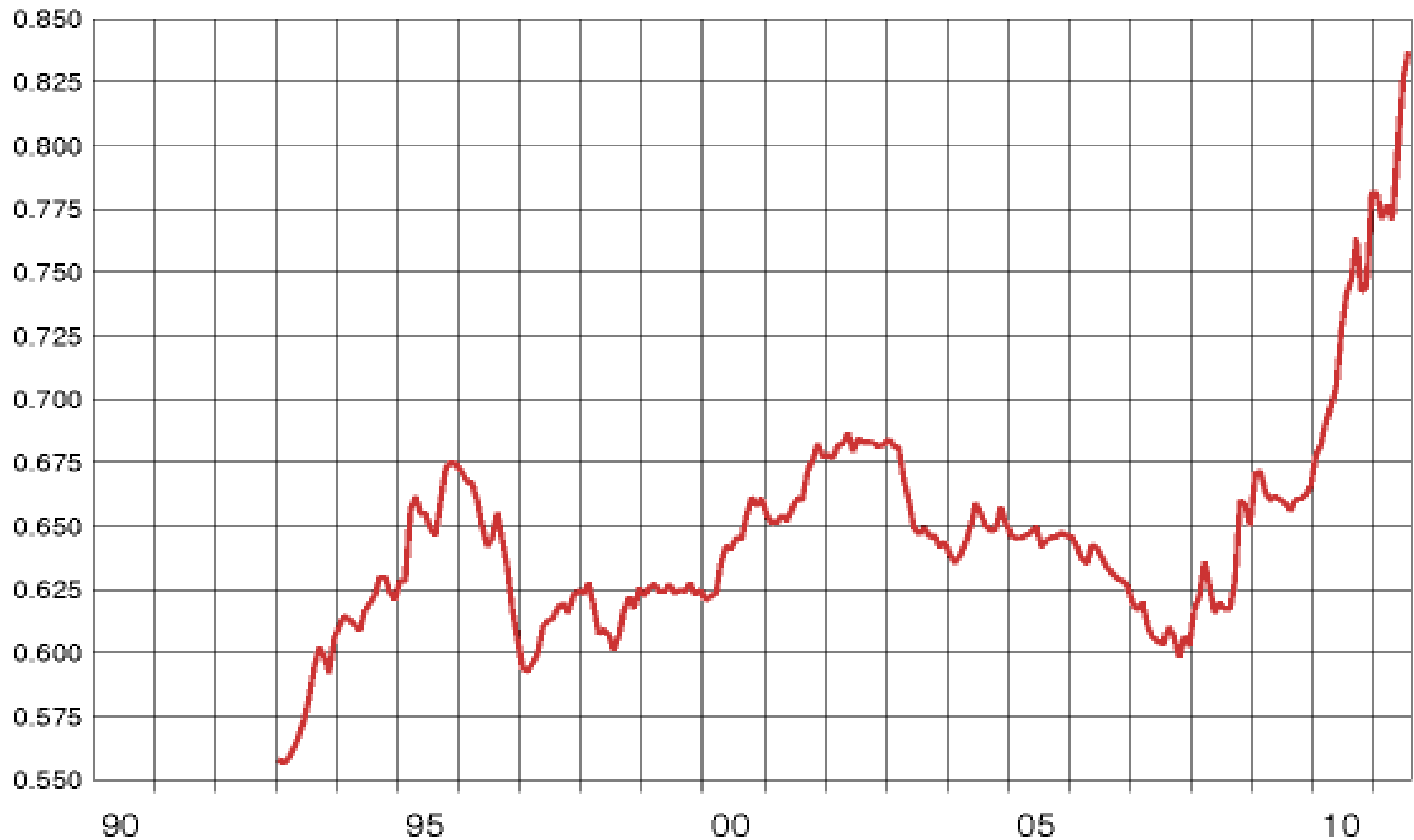
Historically low interest rates on loans in Swiss francs have led consumers in major Central European countries such as Poland, Slovakia, Hungary and the Czech Republic to acquire substantial loans, particularly mortgages, in francs. Currently, 53% of outstanding mortgages in Poland and about 60% of those in Hungary are denominated in francs.

The problem is that these loans are beginning to default at a tune of 10% in Hungary, 1.5% in Poland and 6% in Croatia. If Eurozone enters into a deeper recession these loan defaults are sure to increase.

Swiss Franc has been rising as of late and borrowers are in a triple whammy: their local currency payment has risen as has the value of the debt while exposing the borrower to the rising interest rate charges as these loans are adjusted to the 3-month Libor which has been rising.

PACIFIC Exchange Rate Service

Monthly Avg. Exchange Rates: European Euros per Swiss Franc



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Time period shown in diagram: 1/Jan/1990 - 13/Jul/2011

Reducing the risk of Default

- **Term** – how many years from drawdown? The longer the term the greater risk of exposure. Higher pay back costs but lower installment payments means less risk of default.
- **Repayment** – balloon payment at the end will keep installment payments down and will reduce risk.
- **Interest period** – important decision if there are currency fluctuations. Consider fixing the interest for a number of years, as there is a real risk that interest rates will increase over the next few years.
- **Securities** – try and minimize the securities to be given – avoid personal guarantees.

Strengthening Risk Management Procedures Within Your Organization

- Take legal advice on the security documentation:

- **Danger Clauses:**

- Covenants

- Asset protection clause

- Events of default; narrow down as much as possible

- Deed of Guarantee and Indemnity – what should you look out for

-

- Seek cross indemnities from your partners if this is relevant. Liabilities can arise internally as well as externally.



Risk Management Procedural Steps

Aim for quality ships, quality ship management, quality ship employment, quality financial control

Tax planning

Shock absorption, capabilities

Always plan on worst case scenarios

Do not underestimate the enforcement powers of the Banks.
Please see the Tropical Reefer case (Appendix B)



Forecasting and Managing Risks in Ship Financing

- 1. Risk identification and analysis- access to accurate market information and forecasts- you must know the market and look at tomorrow not today- shipping is highly cyclical.**

These are some of the risk factors in shipping which need to be managed:

- Market conditions; profitability exposure when time charter agreements are renewed.
- Highly cyclical nature of shipping industry may lead to volatility in charter hire rates which may diversely affect vessel values.

Forecasting and Managing Risks in Ship Financing

The supply of order book capacity of certain vessel types may exceed the future growth of demand for vessel capacity which may also adversely affect vessel values.

Rising oil prices could have an adverse impact on the rates charterers are willing to pay



OPEC Basket Price

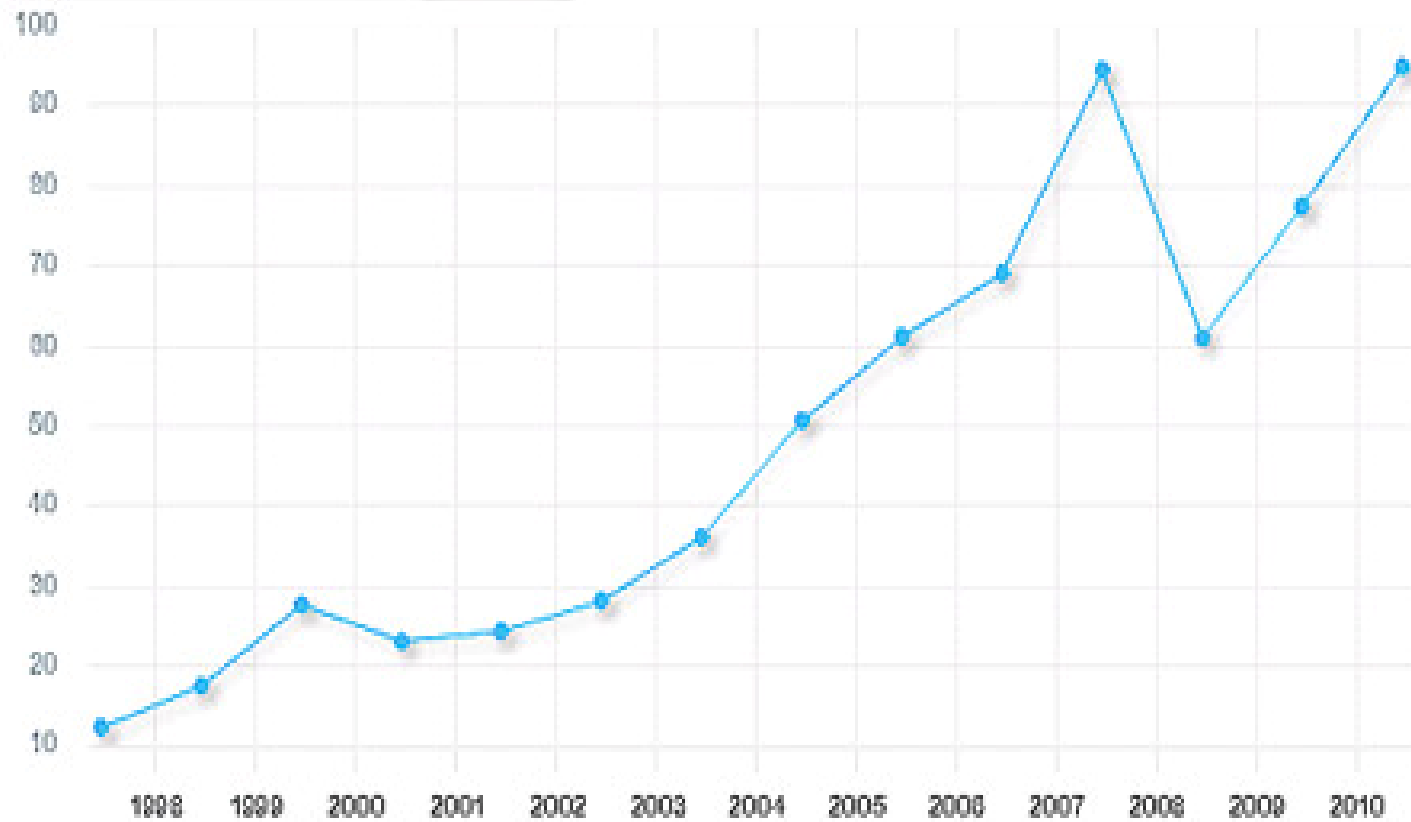
Daily

Weekly

Monthly

Yearly

21/02/11 ▲ 100.59 ...



YEARLY BASKET PRICE

2011	94.93
2010	77.45
2009	61.08
2008	69.45
2007	69.08
2006	61.08
2005	50.64
2004	36.05
2003	28.10
2002	24.38
2001	23.12
2000	27.60
1999	17.48

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Forecasting and Managing Risks in Ship Financing

Shipping industry has inherent operational risks including:

- Damage to vessels and their cargo due to bad weather, mechanical failure, marine disasters, terrorism and human error
- Dry docking costs whilst vessel is being repaired – loss of earnings during period in dry dock
- Port detention due to technical deficiencies
- Periodical surveys must be taken and passed
- Compliance with ISM Code and adherence to Safety Management Systems



Forecasting and Managing Risks in Ship Financing

- Risks of Charterers terminating charter on certain grounds
- Delay in delivery of newbuildings
- Older Ships although cheaper to buy, cost more to maintain
- Risk of arrest by maritime claimants
- Exchange rate fluctuations bearing in mind that income will probably be received in dollars
- Increases in interest rates

Forecasting and Managing Risks in Ship Financing

2. After identification of risks evaluate the best tools to manage these risks:

Performance guarantees

Refundment Guarantees from shipyards in the case of New Buildings
(Please see Specimen Refundment Guarantee at Appendix C)

Insurers – do not economize on insurance – cheap Pand I Insurance can prove to be very costly in the long run.

Loss of hire insurance

Always have an exit strategy

Consider option to sell vessel with time charter attached



Forecasting and Managing Risks in Ship Financing

- Consider pool arrangements which will pool resources and manage risk by dividing employment between trading spot at higher but more predictable rates and on time charter at lower but more secure rates.
- Consider carefully debt to equity ratios
- Target vessels for which demand, supply and prevailing market conditions are favorable
- Charter should at least cover 100% of the financing costs and the operating costs.
- Choose the right flag for the Vessel. Avoid flags which are blacklisted by the Paris and Tokyo M.O.U.'S and which will be unacceptable to Banks.

Forecasting and Managing Risks in Ship Financing

Primary considerations in applying the aforementioned tools:

- (a) reputation of Charterer or the Shipyard (in the case of Newbuildings)
- (b) vessel's sale price compared to future costs of the vessels
- (c) term and structure of Time Charter; aim towards "hell and high water."
- (d) in the case of Newbuildings, the term and structure of the Shipbuilding Contract.
- (e) prospects of vessel's market segment
- (f) expected Vessel's residual value at the end of the Charter - option to sell back to charterer at a fixed price both during and at the end of the charter
- (g) the governing jurisdiction of any Contract signed; aim for English Law and English Courts.

Utilizing Risk management activity to enhance the credit rating of the project, thereby reducing the loan rate

In assessing a project the Bank will put themselves in the shoes of the borrower so you should put yourselves in the shoes of the Bank.



Focus on what you can offer the Bank to minimize their risk. The more securities you can offer the lower the loan rate will be.

Consider offering cross collateralization with other vessels in the fleet.

The Bank will look at both primary and secondary sources of repayment.



NewLead asks banks for time to restructure

DRY bulk and tanker owner NewLead Holdings has said it is in talks with banks to buy itself time to come up with a financial restructuring after hatching an agreement with one lender to sell off two of its bulkers, writes Nigel Lowry in Athens.

The Nasdaq-listed company said it was in discussions with banks regarding short-term standstill agreements and was "hopeful" it could reach an agreement with its lenders, but could not give an assurance of success.

"The discussions are positive and ongoing," a spokesperson told Lloyd's List. "We are working closely with the lenders."

Greece-based NewLead reported a deal it has reached with First Business Bank for the immediate sale of the 22-year-old capesize *Newlead Sparrow*,

while it has agreed to co-operate with the same bank with an auction or judicial sale of the 2003-built handysize *Newlead Prosperity*.

The *Newlead Sparrow* sale must be completed by September 15 and, while market reports have already suggested the vessel has been sold for demolition, the NewLead spokesperson denied this.

"Nothing has been concluded and there is no stipulation in the agreement as to what kind of sale it should be."

The deal with FBR comes after the Greek bank last week issued a notice of default on NewLead, citing failure to pay a \$733,000 instalment on the loan for *Newlead Sparrow*. The same day FBR also arrested the *Newlead Prosperity*.

Currently about \$21.8m is outstanding under the capesize

loan and about \$11.9m is owed under the loan for the handysize.

In positive news for the beleaguered owner, once the two vessels are sold, FBR has agreed to release the company from further obligations, cancelling corporate guarantees and share pledges, NewLead said.

Depending on interest in the vessels, the bank may struggle to recoup the full amount of the loans.

"It is a good deal for us and it is helping to deleverage the company," the spokesperson said.

Altogether the company has about \$252m of indebtedness on its balance sheet, excluding the amounts which look set to be cancelled by shedding the two bulkers and an amount of \$60.7m related to the company's unsecured 7% bond. ■

www.lloydslist.com/drycargo



Thank you for your time!

Any Questions?